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In the Supreme Court
of the United States
OCTOBER TERM, 1979
No. 79-1552

ALABAMA DEPARTMENT OF REVENUE, *et al*,
Petitioners

-v.-

JOHN DAVID FOX, JR., *etc.*
Respondent

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RESPONSE OF RESPONDENT TO APPLICATION FOR WRIT OF CERTIORARI

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HIGGINBOTHAM, INC., ANNISTON, AL

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Petitioners have asked this Court to review and reverse the decision rendered in this matter by the United States Court of Appeals for the Fifth Circuit. That opinion is reported at 609 F. 2d 178 (5th Cir. 1980) and is reprinted as appendix A of petitioners' petition. The ground advanced for granting the writ is that the Fifth Circuit's decision is in conflict with the holding of this Court in *United States v. Sotelo*, 436 U.S. 268, 98 S. Ct. 1795, 56 L.Ed. 2d 275 (1978). For the reasons expressed below, the respondent feels that the decisions are not in conflict.

The issue presented is whether a state created statutory presumption that a tax was collected from others is binding on a bankruptcy court applying §17a (1) (e). If it is, then a withholding tax, even if it is not in fact withheld (for whatever innocent reason), can never be discharged so long as the taxing authority puts a presumption of collection in the statute.

Section 17a (1) of the Bankruptcy Act (11 U.S.C. §35a (1)) was enacted by Congress in 1966 to allow debtors, for the first time, to obtain a discharge of tax obligations in bankruptcy. In pertinent part, it provides:

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: Provided, however, That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) *which the bankrupt has collected or withheld from others*

> *as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . .* [emphasis added]

Though the issue was contested in the Bankruptcy and District courts, the petitioners seem now to concede that the taxes involved here were "legally due and owing" for more than three years prior to bankruptcy. Petitioners confine their objection to discharge on subsection (e) contending that the Alabama sales taxes at issue were collected or withheld from others.

The Alabama sales tax provisions which bear on this question impose the tax as a license or privilege tax on the retailer and require that it be passed on to the consumer.

> *Code of Alabama*, 1975, §40-23-2[1] provides:
>
> There is hereby levied, in addition to all other taxes of every kind now imposed by law, and shall be collected as herein provided, a privilege or license tax against the person on account of the business activities and in the amount to be determined by the application of rates against gross sales, or gross receipts, as the case may be . . .
>
> *Code of Alabama*, 1975, §40-23-2[2] provides:
>
> Every person, firm corporation, association or copartnership engaged in or continuing within this state in the business for which a license or

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[1]At the time of the bankrupt's operations and of his bankruptcy, the quoted statute was found in *Code of Alabama*, 1940, Tit. 51 § 786 (3) (Recomp. 1958). There were amendments to the statute not relevant to this case.

[2]Formerly, *Code of Alabama*, 1940, Tit. 51 § 786 (25) (Recomp. 1958). There were various amendments which do not affect the substance of the provision.

> privilege tax is required by this division shall add to the sales price and collect from the purchaser on all sales upon the gross receipts or gross proceeds of which there is levied by this division a sales tax at the rate of four percent, $.04 tax for each whole dollar of sales price . . . The provisions of this section that there shall be added to the sales price and collected from the purchaser the amounts provided herein shall in no way relieve the person, firm, corporation, association or copartnership described in this section of the tax levied by this article; nor shall the inability, impracticability, refusal or failure to add to the sales price and collect from the purchaser the amounts provided herein relieve such person, firm, corporation, association or copartnership from the tax levied by this division. All taxes paid in pursuance to this division or any other statute enacted in this connection shall conclusively be presumed to be a direct tax on the retail consumer, precollected for the purpose of convenience and facility only.

In the instant case, there is no evidence that the bankrupt actually collected from customers the amount called for by the statute. The petitioner relies instead on the legal fiction that the tax is on the ultimate retail consumer, and the retailer is held to have collected it "for the purpose of convenience and facility."

This is not the situation found by this court in *Sotelo*. That case involved the question of whether a responsible person under IRC §6672 could obtain a bankruptcy discharge of his liabilities under that section. The Court held that he could not. Though the §6672 penalty may be imposed on an individual for

failing to collect the taxes, the Court did not address the question of whether a penalty tax could be discharged when it was imposed merely for failure to collect. The court specifically pointed out that:

> . . . It is undisputed here, moreover, that the taxes in question were "collected or withheld" from the corporation's employees and that the taxes, though collected, have not been "paid over" to the government . . .

436 U. S. at _____, 98 S. Ct. at 1800, 56 L.Ed. 2d at _____.

And, also in disposing of the argument that the sum involved in *Sotelo* was a penalty not a tax the Court noted:

> . . . The funds here involved were unquestionably "taxes" at the time they were "collected or withheld from others . . . " It is this time period that §17 (a) (1) (e) with its modification of "taxes" by the phrase, "collected or withheld," treats as the relevant one. That the funds due are referred to as a "penalty" when the government later seeks to recover them does not alter their essential character as taxes for the purposes of the Bankruptcy Act, *at least in a case in which, as here, the §6672 liability is predicated on a failure to pay over, rather than a failure initially to collect the taxes.* [emphasis added, citations omitted]
>
> *Id.*

The Bankrupt's position is that the *Sotelo* result would have been different if Mr. Sotelo's liability was being predicated on his failure to withhold rather than his failure to pay over the funds collected. The differences in the two situations are reflected in the legislative history of §17a (1). In discussing S. Rep.

No. 114, 89th Cong. 1st Sess. (1965), this Court pointed out in *Sotelo* that §17a (1) (e) as finally enacted was to meet the Treasury's objection that it was "most undesirable to permit persons who are charged with the responsibility of paying over to the Federal Government monies collected from third persons to be relieved of their obligations in bankruptcy when they have converted such monies for their own use."

This Treasury objection to an unlimited discharge illustrates a major distinction. When a businessman collects a tax for the government and rather than paying it over converts it to his use, there is an element of embezzlement and breach of trust which ought not be permitted. On the other hand, when the tax is never collected in the first place, this element of culpability is lacking.

A similar distinction is recognized in COLLIER ON BANKRUPTCY, 14th Ed., ¶17.14 [6], pp 1622-23:

> . . . The distinction should be made here between the tax that is imposed and the tax that is to be collected or withheld. For example, if the employer's share of the social security tax is imposed, it would not fall within this exception; however, the employee's share collected by the employer and not turned over, would fall within this exception.

Under the tax system adopted by Alabama in *Code of Alabama*, 1975, §§40-23-2 and 40-23-26, the tax should be passed on to the consumer. If it is, then under the Court of Appeals' holding, it is a tax collected from others and falls within the exception found in 17a (1) (e). On the other hand, if it is not in fact collected from the consumer under §40-23-26, then the merchant is liable to the state for a license or privilege tax under §40-23-2. This is a tax which may be discharged in bankruptcy under §17a (1) (e).

CONCLUSION

For the foregoing reasons, Respondent respectfully urges that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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PROOF OF SERVICE

I, Herbert D. Jones, Jr., counsel for Respondent and a member of the Bar of the Supreme Court of the United States, certify that I have served three copies of the foregoing brief on the Honorable John J. Breckenridge, Assistant Counsel, Department of Revenue, and Assistant Attorney General, State of Alabama, 201 Administrative Building, Montgomery, Alabama, as counsel for Petitioner, by placing the same in the United States mail, postage prepaid on the 13 day of June, 1980.

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